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EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

**REBUTTAL COMMENTS OF PPL GENERATION, LLC
AND PPL MONTANA, LLC**

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Between now and June 11, 2001, the Board faces the task of analyzing the voluminous record in this landmark proceeding, and deciding on the regulations and explanatory text that will apply to future consolidations among the handful of giant railroads that have emerged over the last twenty years. That this will be no easy task is recognized by PPL Generation, LLC and PPL Montana, LLC (hereafter collectively "PPL"). Nevertheless, certain principles enjoy broad support among the parties to this proceeding, and incorporate the lessons of past experience.

Future mergers should correct the shortcomings of past mergers by mitigating the steady decline in rail-to-rail competition, avoiding service failures and delivering promised benefits. In addition, the Board should recognize that without clear incentives to achieve these goals, applicant railroads may fail to achieve them due to poor planning, poor implementation or the elevation of private over public interests. Simply stated, there has been too little accountability.

I. THE MAJOR RAILROADS MUST BE HELD ACCOUNTABLE FOR MERGER OUTCOMES

The major railroads adamantly oppose any meaningful changes in current merger regulations and policies. With an occasional dissent by UP, the Class I railroads reject the Board's determination that regulations adopted in the early 1980s are no longer adequate in 2001, when a final round of mergers leading to a North American rail duopoly appears imminent.

All other parties to this proceeding -- shippers, shipper organizations, smaller railroads and governmental interests -- disagree with the Class Is, and call on the Board to adopt strong policies, set forth in clearer language than was proposed in the NPR, to meet the current needs of the public.

After thousands of pages of comments on a broad range of issues in this phase of this proceeding and its predecessors, some simplification might be in order. PPL asks the Board to keep the following propositions in mind as it reviews the record:

- The likelihood of achieving public benefits justifying a merger will be increased if the applicants are required to deliver the benefits they project.

- The likelihood of implementation problems will be reduced if the applicants must provide full compensation for such problems.
- The likelihood of implementation problems will be reduced if the applicants cannot simply pass the costs of corrective action on to shippers.
- The national rail system will be less monopolistic and will require less regulation if the applicants are required to enhance competition with other railroads.
- The likelihood of enhanced rail-to-rail competition will be increased if the applicants enter reasonable access agreements (e.g., for terminal trackage rights and reciprocal switching under 49 U.S.C. § 11102), keep gateways open, provide bottleneck rates and grant relief from paper and steel barriers.

The parties' comments appear to reflect considerable agreement on the goals set forth above. The major railroads say they support mergers that produce projected benefits and implementation that avoids service problems. They even claim to support competition. Shippers strongly support these goals. The fundamental disputes between the Class Is and all other parties revolve around ways of achieving or promoting these goals.

Even in this respect, the major railroads do not appear to dispute the propositions set forth above. Their argument is rather that increased accountability for merger applicants is not necessary. According to the major railroads, benefits will be realized, implementation problems will be avoided, and there will be effective competition even if there is no change in current merger regulations and policies.

The problem with these arguments is that they require a degree of faith in the goodwill and selflessness of the railroad industry that the industry has forfeited through its past performance. Moreover, the major railroads' comments in these proceedings do nothing to convince shippers that the mistakes of the past will not be repeated.

No industry in the country has enjoyed the freedom from competition and from burdensome regulation (including antitrust regulation) that the railroads have enjoyed since 1980. The result has been a series of mergers and spinoffs that have reduced rail-to-rail competition and produced numerous service problems. The railroads' only major competitors are the trucking industry, and railroads have done a poor job of competing with motor carriers on service quality and customer responsiveness.[1] PPL submits that the railroads would enjoy more business if they concentrated more on efficient and reliable operations and less on maximizing captive shipper rates and on increasing their market power through

[1] They have, however, managed to block trucking industry productivity gains by opposing any increase in truck sizes or weights.

consolidations.

The major railroads disagree. However, they are ultimately challenging the principle that incentives matter, and arguing that being exposed to the risks of adverse competitive or regulatory consequences will not help deter poor planning, poor performance or the abuse of market power. This contention is incredible on its face.

In any event, it has been proved in rate case after rate case that the railroads will charge unlawful rates unless and until they are ordered to stop. It has been proved in merger after merger that the railroads will preserve only the intramodal competition, minimally defined, that they are required to accept for ICC and Board approval.[2] The pervasive use of paper barriers shows how resistant major railroads are to competition from smaller railroads.

The suggestion that major railroads can simply be trusted to produce projected merger benefits and avoid service problems is belied by the record of poorly planned or implemented mergers in the past few years.

Doubtless, railroad management does not anticipate meltdowns, and seeks to minimize service problems. However, the minimal level of rail-to-rail competition reduces the business losses the

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[2] The breakup of Conrail is arguably an exception, but there have also been many non-merger proceedings in which the major railroads have sought to avoid or limit competition. See, e.g., Ex Parte No. 445 (Sub-No. 1), Intramodal Rail Competition, 1 I.C.C. 2d 822 (1985), the Bottleneck cases, and the market dominance proceedings.

railroads suffer when there are service problems (whether merger-related or not). In addition, the major railroads' enormous market power has largely enabled the Class Is to neutralize the private sector remedies, such as contractual service guarantees, on which they would have the Board rely in place of stronger merger regulations. The major railroads have also vigorously resisted requests by shippers and smaller railroads to be made whole when service problems arise.

The major railroads' past actions are justification enough for new regulations increasing the accountability of merger applicants. It is also important to recognize that future merger proceedings are likely to involve the most significant and largest mergers yet, and to represent the Board's last chance to remedy some of the mistakes of the past. The stakes are higher than ever before, and two of the remaining Class Is may soon absorb all the others, emerging as the two dominant rail systems on the continent.

In light of these facts, one would expect the major railroads to accept modest regulatory reform, and even some additional competition, as a price worth paying. Unfortunately, their comments indicate that their past growth has led to a sense of entitlement bordering on arrogance. The Class I railroads continue to seek the benefits of consolidation without the responsibilities that should accompany such a concentration of market power. The attitudes reflected in most of the positions taken by most of the major railroads therefore provide additional support for stronger and more pro-competitive merger regulations.

The Board faces a clear choice. It can adopt regulations that will increase the accountability of the applicants in major rail mergers, thus increasing the likelihood of well-planned, well-implemented mergers that mitigate concerns about railroad monopoly power. In the alternative, the Board can hope that future merger applicants will voluntarily take the steps necessary to produce projected benefits (even when the costs are higher than anticipated), avoid service problems or make shippers whole (even at some risk to the bottom line), and facilitate effective competition from other railroads including short lines.

This is not a hard choice. The Board must reject the major railroads' arguments for preservation of the status quo.

II. THE MAJOR RAILROADS' ARGUMENTS AGAINST ACCOUNTABILITY ARE SPECIOUS

In their reply comments, as in all of their previous comments, the major railroads go to great lengths to shift the focus of this proceeding away from the central issue of how mergers should be handled in the future. Instead of discussing the kinds of mergers we now need and how to achieve them, the Class Is prefer to attack other parties, misrepresent shippers' positions, and oppose effective remedies for railroad mistakes. As noted above, these positions cannot be reconciled with the major railroads' call for the Board to substitute trust in railroad goodwill for effective regulation. These positions also rule out the accelerated merger schedule the major railroads seek.

The railroads' reply comments are not entirely consistent with their opening comments. BNSF, for example, appears less intransigent on reply than it was in its opening comments. Nevertheless, the major railroads' reply comments continue to reflect positions that are objectionable and wrong.

A. **Enhanced Competition is a Critical Component of the New Rules**

Perhaps the most egregious argument is CSX's claim (Reply Comments at 14-24) that shippers (including PPL) do not support the STB's call for enhanced competition. In Ex Parte No. 582 and in Ex Parte No. 582 (Sub-No. 1), PPL and other shippers have argued vigorously <u>for</u> enhanced competition among railroads, within and outside the context of merger proceedings.

The benefits of competition to shippers are obvious. The more captive the shipper, the greater the power of railroads to charge excessive rates. As the GAO study indicates, STB regulation is rarely an effective remedy for unlawful rates.

In addition, competition is a more effective remedy for service problems than regulation. The railroads may not provide poor service deliberately, but they are more likely to be responsive to the service complaints of shippers with competitive alternatives than to the service complaints of captive shippers. The threat of lost sales is a powerful incentive in most businesses, and more marketplace discipline would be good for the railroad industry.

As CSX is fully aware, shipper criticisms of the NPR's provisions on enhanced competition were intended to strengthen those provisions, not vitiate them, as the major railroads seek to do. Shippers want the reality of enhanced competition, not more empty promises. CSX's attempt to characterize shippers as opponents of enhanced competition is reprehensible.

The resistance of the major railroads to the Board's calls for enhanced rail-to-rail competition simply confirms the point, made by PPL and other shippers, that the Board cannot count on merger applicants to come up with significant enhancements to competition on their own.

The Class Is go so far as to equate competition with regulation, describing shipper calls for trackage rights and reciprocal switching as "reregulation." See, e.g., NS Reply Comments at 20-21, BNSF at 17-19, CSX at 30-37 and AAR at 4. This is nonsense. As Congress, FERC, the FCC and economists have long recognized, access remedies are the opposite of regulation, because the free market and customer choice replace agency litigation.

Ironically, CSX states in opposition to access remedies that "a transfer of profitability from one private party to another at the expense of a lessening of free market competition is not a public benefit, but instead is a private benefit and a public loss." Reply Comments at p. 35. But this is exactly what has been happening for 20 years, as the railroads have reduced rail-to-rail competition in order to extract a higher share of shipper profits in the form of monopoly rents.

In any event, Congress called for terminal area trackage rights and reciprocal switching in the statute (49 U.S.C. § 11102), and the railroads themselves point to the 4000 miles of trackage rights obtained by BNSF in the UP/SP merger as pro-competitive. Even if the Board is unwilling, at this time, to adopt "a broad program of open access" (NPR at 16), it does not follow that trackage rights and reciprocal switching should not be part of the solution to the need for more rail-to-rail competition as railroads consolidate.

At pp. 17-18 of its Reply Comments, BNSF attempts to support the "reregulation" contention with a list of allegedly insurmountable implementation problems. In fact, trackage rights arrangements are plainly not impracticable, since railroads routinely agree to them. It is true that the Board might be called on to set trackage rights charges if the parties cannot agree, but this is not beyond the Board's expertise. The first such decisions would establish policies and precedents reducing the need for further litigation. Similarly, the Board would not have to control operational details such as dispatch. It could simply call for non-discriminatory treatment, and penalize abuse of this straightforward standard.

Equally absurd is CSX's argument, Reply Comments at 44, that because there was no competition between Class Is and short lines prior to track sales by the former to the latter, paper barriers are not anticompetitive. By this reasoning, if Microsoft is split into two companies, the two successors should still be allowed to avoid competing with each other through the simple expedient of agreements specifying what services each company can perform.

The whole point of divestiture orders in merger and monopolization cases is to limit the anticompetitive effects of consolidations. Allowing this goal to be thwarted by paper barriers would be ridiculous even if the smaller railroads go along with anticompetitive terms dictated by Class Is. Here, of course, the Association of Short Line and Regional Railroads and other small railroads have called for relief from paper and steel barriers.

PPL has already dealt with the major railroads' false claim that competitive enhancements would necessarily be arbitrary if not "merger related." PPL Reply Comments at 14-15. The Board should also recognize, and reject, the major railroads' attempt to characterize remedies as "unrelated" to a merger through excessive compartmentalization of railroad actions.

By narrowly defining what is merger related and arguing that all other factors are irrelevant, the major railroads are effectively contending that the Board may not consider their conduct between mergers, or even in anticipation of a merger, in deciding whether a consolidation should be rejected or conditioned. But the applicants' conduct prior to a merger may be highly relevant to the issue of whether a merger is in the public interest.

A railroad that provides poor service (or refuses service except on abusive or extortionate terms), or engages in unfair labor practices, or gouges its customers, or oppresses short lines or refuses reasonable interchange requests may not be the best candidate to control one of two remaining rail systems in North America. Even if such a railroad proposed a merger that could, on balance, be beneficial, it might be wise to impose more conditions than if the applicant had demonstrated more good faith or fewer abusive practices.

The statutory "public interest" standard is flexible enough to permit the Board to consider the track record of the applicants in considering future consolidations, and the Board should not accept the blinders the Class Is would impose. Nor does ICC or STB precedent require that the Board consider only merger-related harms. As IMC Global, Inc. points out in its Reply Comments (at 2-4), the Board has ample authority to broaden its exercise of its remedial and conditioning authority. Given the stakes, very little in the conduct of an applicant for a transcontinental merger approval should be considered "not merger-related" and therefore off limits.

Similarly, the requirement of enhanced competition cannot fairly be characterized as "non-remedial" (e.g., BNSF Reply Comments at 7) merely because the anticompetitive conduct such conditions would remedy happened to take place before a merger application was filed. Therefore, attempts to dismiss the ASLRRA's call for a Bill of Rights (e.g., CSX Reply at 45-46, NS at 47-48, and BNSF at 36) should be rejected.

In any event, the major railroads' opposition is not limited to conditions that they characterize as not merger related. Conditions that are clearly merger related are also opposed where they are perceived as potential constraints on the major railroads' pursuit of their own interests. Apparently, they see no difference between the public interest and their own ambitions. CSX, for example, opposes shippers' call for keeping major gateways open on economic as well as physical terms, even though this issue is merger-related under anyone's definition. See also the UP Reply Comments at 15 and NS Reply Comments at 24-25.[3]

Ultimately, the Board must ask itself whether, as a general rule, an enhanced competition requirement will increase the likelihood that future mergers will be in the public interest. If the answer to that question is yes (and it is), the Board should reject the major railroads' obstructionism and hairsplitting, and impose the requirement as part of its new regulations. Moreover, it should adopt the suggestions of PPL and other shippers for improving the effectiveness of this valuable initiative by clarifying and strengthening the relevant regulations.

B. The Major Railroads Must Be Made Responsible for Producing the Benefits They Project and for Remedying any Service Failures They Cause

Just as the major railroads cannot be expected to accept enhanced competition without STB compulsion, they also must not be allowed to over-promise benefits and under-deliver results. In their Reply Comments, as in their Opening Comments, the Class Is

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[3] To its credit, BNSF (Reply Comments at 10) acknowledges the need to "maintain existing major gateways as open on an operational and economic basis."

argue that they have every incentive to see projected benefits materialize and to avoid short-term (or long-term) service problems. See however, PPL's Reply Comments at 19-20, explaining why these statements are not true.

At the same time, the major railroads argue that shippers who want protection against future meltdowns should bargain for it or pay for it. See, e.g., CSX Reply Comments at 41:

> [T]here are established legal standards for such claims [arising out of service failures] and the judiciary and private agreements provide numerous established forums -- in the rare situations where litigation proves unavoidable. And the marketplace (including rail transportation contracts and the insurance marketplace) offers opportunities for private negotiations and risk allocation even before difficulties might arise.

Ironically, CSX has recently announced that it plans to reduce its use of rail transportation contracts. See the February 7, 2000 issue of Traffic World at 10-11. Obviously, shippers that cannot obtain contracts with major railroads cannot protect themselves, but even where contracts are available, service commitments with penalty provisions are rare. The suggestion that shippers should buy rail transportation insurance before the next major merger is a variant of "Let them eat cake."

BNSF expresses surprise that shippers would seek compensation for railroad inflicted damage even if the railroads comply with their contracts. Here again, the argument is disingenuous. BNSF has almost discontinued the use of grain transportation contracts, no railroad is under any obligation to contract with any shipper, and contractual service commitments are always resisted by the railroads. Many transportation contracts drafted by major railroads do not even state explicitly that the railroad will haul the shipper's freight. Under the circumstances, looking only to rail transportation contracts to determine the extent of merging railroads' liability for service failures amounts to eliminating almost all such liability.

UP deserves some credit for recommending "a base level of financial protection" for those shippers that "lack the resources or bargaining power to reach agreements with applicants" but nevertheless "deserve a remedy if they suffer substantial and harmful service failures." Reply Comments at 11. However, even UP's approach is inadequate because (1) it assumes only small shippers would need such assistance, (2) it assumes there should be no remedies for service failures short of meltdown, and (3) UP's proposal, as set forth in its ANPR Comments (Appendix A to UP's Opening Comments on the NPR), is inadequate. See PPL's Reply Comments in the ANPR phase of this proceeding at 20-22.[4]

To the extent that remedial action to deal with service failures cannot be avoided, the major railroads nevertheless seek to limit their exposure through their tactic of compartmentalization. See, e.g., BNSF Reply Comments at 11, arguing that remedies

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[4] Similarly, UP's revived bottleneck proposal (Reply Comments at 13-14) while not devoid of merit, is undermined by UP's call for a showing of market dominance over the entire route. See PPL's ANPR Reply Comments at 12-13.

should be available to shippers only if service deteriorates for "merger-related" reasons. Evidently, if BNSF merged with NS, BNSF could provide poor service in the West, and NS could provide poor service in the East, and no shippers could obtain relief so long as the railroads could argue that the service failures were not merger-related. STB oversight would be similarly constrained.

By narrowly defining what is "merger related," the major railroads attempt to minimize their exposure to liability for service failures, as well as their responsibility to enhance (or even preserve) competition. This "shell game" may serve the major railroads' interests, but it would further deprive shippers of their remedies, and would eliminate the incentives that are clearly needed if future mergers are to avoid the problems of the past.

If the Board seeks to maintain integrity in its rail merger proceedings, avoid service failures, and enhance the likelihood that projected benefits will be realized, lip service is not the answer. The Board must make the major railroads accountable for their projections, and for their errors of planning or implementation. Relief in the form of a waiver by the Board may be available in the event of truly unforeseeable obstacles, but delivering projected benefits must not be optional.

III. CONCLUSION

The Board's laudable goal of "raising the bar" in future merger proceedings is undermined by ambiguous and weak language in its NPR. As presently drafted, the proposed new regulations rely too much on major railroads to accept obligations with respect to new competition, the realization of projected benefits, and compensation for service failures that the Class Is plainly oppose.

PPL therefore urges the Board to replace its vague, precatory language with clear requirements that expose major railroads to appropriate risks and burdens if they fail to achieve the goals all parties appear to share. If there are to be further consolidations among major railroads, an appropriate quid pro quo for merger approval is that the applicants must remedy their own anticompetitive conduct, avoid or provide full compensation for any service failures, and accept responsibility for delivering their projected benefits. Putting railroad management and shareholders at risk for the failure to satisfy these criteria is the best way of insuring compliance.

PPL appreciates the opportunity to address these issues, and commends the Board for amending its merger regulations to address today's new challenges.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing pleading has been served, by first class mail, postage prepaid, on all parties of record this 11th day of January, 2001.

John M. Cutler, Jr.

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